

**BEFORE THE CALIFORNIA ENERGY COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of:

Preparation of the
2005 Integrated Energy Policy Report

Docket No. 04-IEP-1K

**COMMENTS OF THE COGENERATION ASSOCIATION OF CALIFORNIA AND
THE ENERGY PRODUCERS AND USERS COALITION ON THE 2005
COMMITTEE DRAFT TRANSMITTAL REPORT**

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The Cogeneration Association of California¹ (CAC) and the Energy Producers and Users Coalition² (EPUC) submit the following comments to the California Energy Commission (Energy Commission) on the 2005 Draft Transmittal Report (Report). The comments are submitted pursuant to the Energy Commission's October 25, 2005 Notice of Committee Hearing and Availability of the 2005 Committee Draft Transmittal Report.

CAC/EPUC supports the policy recommendations for CHP resources contained in the Report at pages 14-15. As stated in CAC/EPUC's October 14, 2005 comments on the draft IEPR, the recommendations address real obstacles

¹ CAC represents the power generation, power marketing and cogeneration operation interests of the following entities: Coalinga Cogeneration Company, Mid-Set Cogeneration Company, Kern River Cogeneration Company, Sycamore Cogeneration Company, Sargent Canyon Cogeneration Company, Salinas River Cogeneration Company, Midway Sunset Cogeneration Company and Watson Cogeneration Company.

² EPUC is an ad hoc group representing the electric end use and customer generation interests of the following companies: Aera Energy LLC, BP America Inc. (including Atlantic Richfield Company), Chevron U.S.A. Inc., ConocoPhillips Company, ExxonMobil Power and Gas Services Inc., Shell Oil Products US, THUMS Long Beach Company, Occidental Elk Hills, Inc., and Valero Refining Company - California.

to CHP preservation and development and will facilitate retention of the many benefits which these resources provide to the State. The Report's recommendations are appropriately based upon a comprehensive review of the issues through staff and consultant reports, the receipt of both oral and written comments from all interested parties, and full day workshops on the issues.³

The Report's recommendations are also consistent with the energy agencies' efforts to coordinate the IEPR and procurement proceedings. The March 14, 2005 Assigned Commissioner's Ruling (ACR) addressed how the 2005 IEPR and 2006 CPUC procurement proceedings would be coordinated.⁴ Specifically, the ACR sets forth what should be included in the Energy Commission's Transmittal Report as follows:

As part of the 2005 IEPR process, the CEC will also prepare a "Transmittal Report" for use by the CPUC in the 2006 procurement proceeding; that document will contain the specific information identified in Commissioner Peevey's ACR issued September 16, 2004, in R.04-04-003, and in D.04-12-048. (ACR at 6)

Attachment A to the September 16, 2004 ACR sets forth the specific information required. Attachment A notes in pertinent part that the "CEC's 2005 Integrated Energy Policy Report ("IEPR") process will estimate need for resource additions, evaluate policies and recommend appropriate resource strategies for the state to meet forecasted load on a biennial cycle." This process includes but is not limited to recommending "broad, statewide resource preference policies."

³ The Assessment of California CHP Market and Policy Options for Increased Penetration, April, 2005, alone is 185 pages long.

⁴ Assigned Commissioner's Ruling Detailing How The California Energy Commission 2005 Integrated Energy Policy Report Process Will Be Used In The California Public Utilities Commission's 2006 Procurement Proceedings And Addressing Related Procedural Details, R.04-04-003, March 14, 2005

Attachment A goes on to note that the “*CPUC’s procurement process will produce IOU-specific procurement plans, require competitive generation solicitations, incorporate needed transmission upgrades and guide preferred resource acquisition to ensure resource adequacy on a biennial cycle beginning in 2006.*” As part of this process the “*CEC provides ranges of likely need and resource assessment for individual IOUs and statewide policy preferences from IEPR.*” (emphasis added) Accordingly, the Report’s recommendations for CHP are completely consistent with Commissioner Peevey’s ACR.

The recommendations contained in the Report are also consistent with Governor Schwarzenegger’s review of the Energy Commission’s 2004 IEPR Update. In response to the recommendation in the IEPR that the forecasts, resource assessments, and policy preferences of the Energy Report would be incorporated into an explicit resource adequacy requirement for all retail electricity suppliers to guide resource procurement, the Governor replied:

*The California Public Utilities Commission (CPUC) has already indicated in its recent rulings and decisions that the products of the Energy Commission’s Energy Report will be used to guide long-term resource procurement in CPUC proceedings. Both agencies are to be commended for this effort.*⁵

More specifically, in response to the recommendation that a transparent electricity distribution system planning process that addresses the benefits of distributed generation, including cogeneration, should be created, the Governor responded:

I agree. An important benefit of clean distributed generation for electricity systems is that it can occur right at load centers, reducing the need for

⁵ Review of Major Integrated Energy Policy Report Recommendations (Review) at 1 (August 23, 2005 correspondence to Honorable Don Perata).

*further infrastructure additions. The CPUC should develop tariffs that encourage the installation of distributed generation and cogeneration systems.*⁶

The Governor concluded his review by stating in pertinent part: “[t]he *Energy Report* is, as I have modified its assessments and recommendations pursuant to Public Resources Code 25307(a-b), a sound basis for energy policy analysis and development, going forward. I expect all state agencies to use it as a common foundation for making their energy related decisions.” (Review at 14)

Most significantly, the recommendations contained in the Report are critical in light of the positions taken by the California utilities at the CPUC regarding the preservation of existing, and development of new, CHP resources. In sharp contrast to the positive recommendations contained in the Report, Southern California Edison Company (SCE) and Pacific Gas & Electric Company (PG&E) (collectively, Utilities) proposals in the long-term QF policy proceeding (R.04-04-003) would actually serve to discourage these valuable resources.

The Utilities offer both existing and new CHP facilities three options as an alternative to the targeted recommendations contained in the Report. The first is for CHP resources to bid into utility requests for offers (RFOs).⁷ The Utilities submit this proposal despite the fact that for the most part, they seek resources which are freely dispatchable; a status which the Report recognizes CHP does not have due to CHP’s thermal load requirements. (IEPR at 77) As one example of this, on November 3, 2005, Watson Cogeneration Company submitted

⁶ Review at 6.

⁷ PG&E Prepared Testimony in R.04-04-003, August 31, 2005 at 4-1; SCE Prepared Opening Testimony in R.04-04-003, August 31, 2005 at 109.

comments to the Energy Commission on the IEPR describing in part their experience with a recent RFO issued by SCE. A copy of Watson's comments is attached for the Energy Commission's convenient reference. Moreover, the offer for CHP to bid into RFOs (even assuming that non-dispatchable CHP would be eligible to bid in the RFO) seems particularly hollow when the utilities continue to acquire significant resources, resources which displace the need for CHP capacity, completely outside of the RFO process.

The second option is for CHP resources to attempt to negotiate long-term contracts with the Utilities.⁸ The IEPR Committee is well aware of and has appropriately noted in the IEPR that the IOUs recent history of negotiating long term contracts with CHP operators has not been a positive one. (IEPR at 76)

The third option is a one year contract at market prices.⁹ One year contracts simply do not incent generators to invest in upgrades or significant maintenance to existing facilities or to build new facilities. As noted in the IEPR, long-term contracts with a minimum ten year term are required in order for CHP owners to make well-informed investment decisions and provide assurances to both the Energy Commission and the Utilities of the long-term availability of these resources. (IEPR at 77-78)

The primary concern of industrial processes that require steam is insuring that steam supply. This can be accomplished through either existing or new

⁸ PG&E Prepared Testimony in R.04-04-003, August 31, 2005 at 4-1; SCE Prepared Opening Testimony in R.04-04-003, August 31, 2005 at 112.

⁹ PG&E Prepared Testimony in R.04-04-003, August 31, 2005 at 4-1; SCE Prepared Opening Testimony in R.04-04-003, August 31, 2005 at 113.

CHP facilities or through boilers. The CHP option requires a repository for the electric energy produced by the CHP process, often on a 24/7 basis. Options which threaten the reliable delivery of steam to the industrial process simply will not encourage either existing or new CHP operations. The Utilities proposals do not provide any assurances that industrial facilities can rely upon CHP to provide their steam requirements because none of the Utilities proposals insures a reliable repository for the CHP process electric energy. In short, the Utilities proposals serve to discourage CHP and will not achieve the Energy Commission's IEPR goals of retaining existing CHP capacity and encouraging the development of new capacity. The Utilities' hostility to CHP operators is further exemplified by testimony filed by PG&E in R.04-04-003 which attempts to incorrectly characterize state policy preferences toward CHP (presumably including the Energy Commission's IEPR) as only applying to facilities smaller than 20 MW;¹⁰ an interpretation clearly at odds with the express intent of the IEPR to preserve and promote CHP of all sizes.

CONCLUSION

The Utilities' proposals for CHP at the CPUC emphasize how critical the Report's recommendations are for the preservation of existing CHP resources and the encouragement of new resources. CAC/EPUC fully supports the Report's recommendations and look forward to working with the Energy Commission on implementation of the recommendations in the CPUC's 2006 procurement process.

¹⁰ PG&E Rebuttal Testimony in R.04-04-003 at 2-11.

Dated: November 8, 2005

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Michael Alcantar". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Michael Alcantar
Rod Aoki

Counsel to the Cogeneration
Association of California

A handwritten signature in black ink, appearing to read "Evelyn Kahl". The signature is cursive and elegant, with a long horizontal stroke extending to the right.

Evelyn Kahl
Nora Sheriff

Counsel to the Energy Producers
and Users Coalition

ATTACHMENT



Watson Cogeneration Company

22850 South Wilmington Avenue
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Thomas A. Lu
Executive Director

November 3, 2005

Mr. Joe Desmond
Chairman
California Energy Commission
1516 Ninth Street
Sacramento, CA 95814

Mr. Michael Peevey
President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

RE: Implementing the 2005 IEPR - Creating a Cogeneration Portfolio Standard

Dear Chairman Desmond and President Peevey:

We support the California Energy Commission's efforts to establish sound energy policy for California and appreciate your recognition of the important role and benefits that cogeneration provides to our state. Implementation of your cogeneration policy recommendations, in the form of a Cogeneration Portfolio Standard, constitutes a key element of the necessary framework to maintain continued investment in cogeneration resources that are so important to California energy supply and security. Regulatory certainty in the form of long-term commitments for the delivery of power under just and reasonable conditions is vital to a cogeneration facility and its thermal host.

Cogeneration is among the most effective and efficient forms of power generation available because it generates very real and quantifiable environmental and energy savings compared to separate production of heat and electricity. The Energy Action Plan II and 2005 Integrated Energy Policy Report (IEPR or the Report) have correctly identified cogeneration as a key element of California's loading order strategy that will help meet the state's energy efficiency and renewable energy goals. Therefore, continued promotion of cogeneration in California in the form of a Cogeneration Portfolio Standard is part of a sound strategy for the efficient use of energy that is both complementary and supplementary to the strategy of increased use of renewables.

Businesses in California with legitimate thermal needs utilize heat associated with the production of electricity to make cogeneration a cost effective, low-emission generation option that provides for efficient use of limited natural gas resources and helps meet California's growing energy needs. Cogeneration is a viable end-use efficiency strategy for California businesses and an essential element of customer choice that helps keep industrial users commercially competitive while also providing the benefits of diversification that are critical to the continued reliability and security of California's power grid, transportation fuels and industrial infrastructures.

Cogeneration enhances reliability by decreasing the grid's peak load requirements and benefits the IOU's and ratepayers by relieving congestion on the transmission system, providing ancillary services and reducing electric line losses and transmission costs. From a security standpoint, cogeneration facilities were also largely responsible for keeping the

lights on in California during the darkest days of the 2000-2001 energy crisis, many running months without certainty of payment in order to maintain the viability of critical state industrial infrastructure. Most recently, Hurricanes Rita and Katrina in the Gulf Coast area of the United States have provided additional lessons in the importance of cogeneration in sustaining infrastructure so critical to our economy and national security. On-site cogeneration at industrial facilities such as refineries and chemical plants were key to getting those operations up and running again while other facilities dependent upon the power grid waited weeks for restoration of transmission facilities.

Watson Cogeneration Company is an important contributor to California's energy infrastructure. The facility produces enough power to supply over 400,000 homes and, as the sole provider of process steam and power to BP's Carson refinery, is literally the engine behind the production of 20% of California's in-state production of gasoline, 30% of its diesel, and a significant portion of the jet fuel that supplies LAX. However, given the current state of the California energy market, Watson's ability to continue to fulfill this role depends on the certainty that only a long-term power sales agreement can provide; it is the certainty of a buyer for the project's power that ensures Watson will be able to cogenerate both steam and electricity dependably, efficiently, and without interruption.

Simply put, unless Watson has the certainty of a home for its base-loaded power after its current SCE contract expires in April 2008, it cannot commit to continue to provide process steam to the BP refinery. In turn, BP's need for a reliable supply of steam is too critical to allow it to wait until the last minute in the hopes that a buyer for Watson's power will suddenly emerge. Absent firm commitments on steam and power sales, at some point the refinery will have no choice but to secure an alternative source of reliable steam (including industrial boilers); this will both eliminate the inherent environmental and fuel efficiencies provided by Watson as a cogeneration facility, and jeopardize Watson's ability to continue to generate power for the LA basin.

Testimony provided to the CEC and its staff during the IEPR proceedings has clearly identified and accurately described the obstacles faced by other existing and proposed cogeneration projects. The utilities in their filings and comments to the Report have intimated that there are no major barriers to the development of cogeneration in California. However, clear and compelling evidence presented during hearings for the IEPR and elsewhere demonstrates that this is simply not the case.

SCE issued a 5-Year Request for Offers on or about July 1, 2005 in which it invited non-dispatchable qualifying facilities to submit offers. Watson's view is that SCE's expressed encouragement for **non-dispatchable** base-loaded QFs to participate in this RFO appeared to be in direct conflict with their stated preference for this RFO. The RFO Transmittal letter clearly stated that, "SCE is primarily interested in receiving offers for **dispatchable** (*emphasis added*), low capacity cost, higher heat rate tolled units located within the Los Angeles area ..." and "QF resources that are **dispatchable** (*emphasis added*) during on-peak periods or curtailable during mid-peak and/or off-peak periods...". QFs, by their basic design and purpose, are inherently **non-dispatchable**, which brings into question the genuineness of the invitation for QFs to participate in this RFO. Nevertheless, Watson submitted a timely and competitive offer in response to this RFO. Now, a full 4 months after the solicitation, Watson still faces cessation of its contract, despite its long history of dependable service to SCE. Perhaps this is why standard offer contracts for non-dispatchable cogeneration resources were necessary in the first place, to ensure that sound energy policy could be fairly implemented for the benefit of Californians.

The CEC has proposed realistic and sound solutions to the obstacles facing cogeneration as identified in the IEPR and correctly states, "current state policy must change for California to tap into this potential generation source and, equally important, retain the existing pool of CHP (cogeneration) so critical to the reliable operation of the grid." Regulatory certainty is vital to a cogeneration facility and its thermal host; therefore the state policy objectives identified in the IEPR should be implemented by the creation of a Cogeneration Portfolio Standard.

By instituting a **Cogeneration Portfolio Standard**, the CEC and CPUC can establish the necessary framework to maintain continued investment in cogeneration resources that are so important to California energy supply and security. Elements of an effective plan should include

- (1) A minimum goal for procurement from cogeneration resources in the IOUs integrated resource investment plans,**
- (2) A requirement that, absent the availability of a viable long-term standard offer contract, each of the state IOUs enter into negotiations for bilateral extensions of existing cogeneration QF contracts within a reasonable timeframe,**
- (3) Meaningful recognition (i.e. through dispatch restrictions and CAISO tariffs) that cogeneration resources run in order to meet the needs of thermal hosts. For operational reasons, most cogeneration facilities must run continuously on an around-the-clock basis.**
- (4) Incentives for cogeneration projects that reduce congestion by providing transmission and distribution benefits in load centers (e.g. through a local reliability capacity payment)**

Watson Cogeneration Company urges the CEC, CPUC, and CAISO to work together and take the necessary actions to implement a sound cogeneration policy that ensures efficient cogeneration resources can continue to meet California's growing energy needs by removing the regulatory barriers and uncertainty that are discouraging cogeneration retention and new development.

Respectfully,
Watson Cogeneration Company

Thomas A. Lu
Executive Director

cc: Mike Chrisman, Secretary for Resources, State of California
Dan Skopec, Deputy Cabinet Secretary, Office of the Governor
Dennis Albiani, Deputy Legislative Secretary, Office of the Governor
Geoffrey Brown, Commissioner, California Public Utility Commission
Susan Kennedy, Commissioner, California Public Utility Commission
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